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Evaluating the Impact of QIZ Protocol on Egypt's Textile and Clothing Sector

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ABSTRACT

Since the enforcement of the Qualified Industrial Zones (QIZ) protocol signed by Egypt in December 2004, the number of QIZ companies have steadily increased, reaching 1048 companies in 2019. Additionally, the QIZ textile and clothing exports have increased, as well as its percentage from Egypt's total exports to the USA. The paper seeks to study and explore the conditions and circumstances that induced Egypt to sign the QIZ agreement. The paper will then review several previous studies on the impact of the agreement on the Egyptian textile and clothing sector. We will also review the trend of the number of QIZ companies. Additionally, in order to assess whether the QIZ protocol have a positive impact on the textile and apparel sector, we will evaluate the trends in the Egyptian textile and apparel exports to the USA and what percentage does these exports constitute from Egypt's total exports.

Keywords: QIZ, Exports, Textile sector

INTRODUCTION

Qualified Industrial Zones (QIZ: The US-Israel FTA Enforcement Act describes QIZs as 23 "Israel and Jordan or Israel and Egypt," locally recognized as the zone where products may be accessed without duty or excise taxes payable "and the American Trade Representative (US Trade Representative). Current custom is to issue an intellectual property QIZ status, which allows individual producers to try their goods for approval (Kardoosh & Director, 2005)) are some geographical areas within Egypt which are duty-free with the United States. Industries in these areas are given duty-free entry to the United States, provided that they comply with the Israeli portion decided in compliance with their predefined rules of origin. The benefits of the QIZ agreement to Egypt are diverse; the most important facilities of entry are unrestricted, limitless

quota and a waiver of tariffs and non-obstacles. Certain advantages include low cost and a large supply of labor.

Enhanced by the additional advantages of trade agreements with other countries, Egypt gives the companies in those areas endless economic benefits. The positive economic impact of the QIZ so far was the improvement in competitiveness and productivity in these regions with the keen of foreign investors and Egyptian companies to seek and enter a business in these regions (QIZ, 2019).

In 1996, the USA developed the concept of Qualified Industrial Zones (QIZ) to strengthen peace in the Middle East through regional partnerships in Arab countries as well as in Israel. For that reason, the United States in December 1996 issued Decree 6955, which allowed duty-free entering the United States under international rules of origin in respect of industrial goods originating in Egypt and produced in conjunction with Israel (QIZ, 2019).

Jordan became the first nation in the world to join a QIZ Agreement back in 1999 and has subsequently experienced significant positive economic impacts. In deciding how to enforce a Policy for Egypt, the government of Egypt took note of this with several other considerations. In addition to Jordan's results, Egypt also acknowledged the danger to Egypt's foreign competitiveness in the garment and apparel industry as a consequence of phasing out proportional quotas for textiles by the World Trade Organization (WTO) (QIZ, 2019).

The government of Egypt concluded the Treaty on the Qualified Industrial Zones with the United States and Israel on 14 December 2004. This Agreement permits the duty-free entrance into the United States for goods made by eligible firms in Egypt that fulfill the Israel quality presently accepted of 10.5 % inside specified geographical locations.

It has been set up to develop economic relations between Israel and its neighbors. Effective February 2005, the agreement has made duty-free entering the United States possible for the goods manufactured jointly by Egypt and Israel. Registered goods must have a value-added by QIZ plants of at least 35%. At least one-third (11.7%) must be contributed by Egypt and 10.5% must be contributed by Israel. Although the administration of Egypt held discussions in 2017 to lower Israeli input to 8% and extend the reach of the system to include technology firms, the protocol has remained unchanged since it started (QIZ, 2019).

The paper is trying to investigate the impact of the QIZ protocol on Egyptian textile and apparel exports to the United States.

HISTORICAL BACKGROUND

For many years Egypt has been pursuing a Free Trade Agreement (FTA) with the United States to expand trade. However, due to the shifts in the United States as well as the global trade conditions, Egypt has failed to reach an Egypt-US FTA. That is why Egypt agreed to the QIZ protocol as the second-best option to increase the country's competitiveness in the United States market. There were three main changes in the trade conditions at that time which induced Egypt to sign the agreement. First, the phasing out of the Multi-Fiber Agreement (MFA). Trade in the textile and

clothing sector was controlled by a quota system, for almost 30 years, which restricted the imports from global competitive producers.

The quota system was completely eliminated on January 2005 and it was expected that this elimination would have major impact. The first two stages of elimination, which began in 1994, had no major effect on importers and producers. This was because the quota elimination was applied mostly to import products that were below their quota limits. Second, China becoming a WTO member. Before joining the WTO, China could not benefit from the Agreement on Textile and Clothing (ATC) as well as quotas elimination. Nonetheless, after China joined the WTO in December 2001, it was granted the benefits of the ATC. Consequently, China was expected to become the leading Textile and Clothing (T&C) exporter since the country has the greatest manufacturing capacities for cotton, silk, and man-made fibers (MMF). In addition to other factors such as low wages, high productivity, and advanced technology. Moreover, the T&C exports from China to the United States and the European Union have increased substantially after its WTO membership, which threatened other competitors. Third, the increasing number of USA preferential trade agreements as well as free trade agreements. Egypt's exports were subjected to the United States Most Favored Nations (MFN) tariff rates, prior to 2005.

Thus, countries which have signed FTAs or preferential trade agreements with the US had more favorable positions compared to Egypt. This is because the average tariff rates implemented under FTAs and unilateral agreements were lower than the average US MFN tariff rates. Therefore, Egypt sought to have similar trade agreements with the USA, especially after witnessing the great performance of countries like Mexico and Jordan, which have seen a significant increase in their exports to the USA market after signing trade agreements (Refaat, 2006).

LITERATURE REVIEW

Refaat (2006), conducted a study in order to evaluate the impact of Egypt's qualifying industrial zones (QIZ) agreement on the textile and clothing sector. In addition to examining the changes in textile and apparel exports to the USA before and after the agreement, the author conducted a survey as well as interviews with various QIZ companies. This was done in order to assess the impact of the protocol on the performance of these companies. The results indicate that following the enforcement of the protocol, the QIZ exports have witnessed an upward trend. In addition, the number of exporting QIZ firms have increased from 54 to 96 between June 2005 till March 2006. Most exports are apparel while textile products comprise a small percentage. Between the period from March 2005 to February 2006, 97% of the exports were apparel and textile products under the QIZ program. By the beginning of 2006, Egypt's apparel exports under the QIZ protocol constituted 90% of total apparel exports to the USA. Regarding the performance of the QIZ companies, the survey results indicated that 48 companies were already exporters before the QIZ agreements. Apart from one company, all companies were privately owned. As for the impact of the protocol on these companies' activities, 38 companies reported that their exports grew after the agreement.

Only 7 companies reported that their exports remained constant, while 4 companies reported that their exports decreased. The average exports increase was 37%. Employment increased in 33 companies with 5,617 workers, mainly Egyptians. With respect to the Israeli inputs, 28 companies said that Israeli inputs were 20% higher than domestic or foreign substitutes. Additionally, 18

companies reported that their export prices increased as a result of the higher Israeli input prices. The paper concluded that major Egyptian exporters were successful in increasing exports and employment after the agreement. However, exporting was limited to already existing exporting companies, which is expected since producing competitive goods and exporting them is a lengthy process. The author stated that in order to benefit from the agreement on the long run, the competitiveness of domestic companies should be improved, and the government needs to renegotiate Israeli input share in local content requirement (Refaat, 2006).

Another study conducted by Nugent & Abdel-Latif (2010), sought to examine trade creation and trade diversion between countries involved in the QIZ agreement. The paper looked into other effects of the protocol other than trade such as employment. The authors explained that since Egypt grow cotton locally, it has more raw materials and a well-established textile sector which is less dependent on imports compared to Jordan. Nonetheless, the integration of Israeli inputs is mandatory according to the QIZ protocol. Since Egypt's imports from Israel are mainly intermediary goods like fabrics, and accessories, which are cheaper in China, this creates trade diversion. Thus, trade creation benefits of the protocol need to be balanced with this cost of trade diversion. But since investors are engaging in these QIZ Activities, this means that they consider the benefits of trade creation are greater than the costs of trade diversion.

The study also found that the growth rates of Egyptian exports because of the protocol witnessed the highest increase of 42% in 2006/2007. A decrease in the following year was recorded because exports have shifted to the European Union market. Another crucial observation is that in the first quarter of 2009, exports surpassed the previous year by 12.4% despite of the global recession and the financial crisis. In contrast, other major exporters witnessed a poor performance and a greater decrease in their exports. This increase in Egypt's exports came at a time when there was a decrease by 16% in US apparel imports which indicated that Egypt has gained status in the US market. Additionally, the authors found that increasing garment exports to the US market has created more jobs. The QIZ agreement also had a positive transfer of technology and know-how to Egyptian producers due to the sophistication of US consumers.

QIZ researches are rare, and this is so in Egypt in particular. Two economic surveys in Jordan and Egypt concentrate on QIZs ' direct production and export outcomes, in order to determine short- and medium-term economic impacts. All studies argue that QIZs have not provided economic change though considering the agreement's political essence (Strikou, 2018).

These are part of US efforts to encourage international markets on the grounds of the premise that global investment would strengthen socioeconomic classes or new business, thereby contributing to the democratization and normalization of ties with Israel. As predicted, authors consider quite the contrary impact because business oriented people misuse their former social and political structures and they do not turn them into the international exchange (Strikou, 2018).

QIZ became a vital part of the former Egyptian President Hosni Mubarak's attempts to ensure the future of his government through the notion of national interest. He concluded that Mubarak used the strategic significance of Egypt through the project to alleviate US pressure on human rights and democracy, and to encourage economic liberalization in Egypt (Strikou, 2018).

EFFECTS OF THE GLOBAL CRISIS ON THE EGYPTIAN TEXTILES AND CLOTHING SECTOR

The textiles and clothing (TC) division did not escape the slowdown. Nevertheless, it has deteriorated as a consequence of a growing economic climate since 2001. The recession had badly impacted shipments, which were saved by the Qualified Industrial Zones (QIZ) and Euro-Cooperation Agreements. The liberalization led domestic revenues to decrease, and non-QIZ exporters who were unguarded by the deal were struggling against non-exports into the domestic sector. By compensating for the export growth, if domestic revenues begin to decline, the sector would continue to decrease. Short-term stabilization programs should be called to provide banks with liquidity and social security for employees in troubled businesses in order to deal with this crisis. Nevertheless, the industry had underlying systemic flaws that contributed to rising costs. This has accelerated the loss of an already challenging sector, so it required a longer-term approach beyond the recession, including the transition to the supply chain of the textile business, reciprocal export opportunities, improving expertise and full structural change (El-Haddad, 2012).

THEORETICAL FRAMEWORK

Throughout history various theories have tried to explain how and why countries should trade with each other. Adam Smith; for instance, proposed the theory of absolute advantage. He believed that for countries to gain from trade, each country should specialize in the production of goods that have absolute advantage; goods that the country can produce with lower costs. Nonetheless, this theory failed to explain why countries who lack an absolute advantage still engage in international trade. David Ricardo attempted to bridge this gap by stating that countries should trade based on comparative advantage rather than absolute advantage. He explained that a country should produce and export commodities in which it has the higher comparative advantage and import commodities in which it has the lower comparative advantage. Later, Eli Heckscher and Bertil Ohlin developed the Heckscher-Ohlin model from David Ricardo's theory.

They stated that trade is based on differences in factor endowments. A country will produce and export goods which requires the intensive use of the country's abundant factor and import goods that require the intensive use of the countries scare factor. We can conclude that the classical trade theory focused only on trade between different countries. Consequently, the new trade theories focused on explaining intra-industry trade and trade between nations that have similar or equal factor endowments. The new trade theories draw more attention on economies of scale, product differentiation, and imperfect competition (Binh, Duong, & Cuong, 2011).

The Gravity Model

Bilateral trade flows have been widely explained by the gravity model. The model is based on Newton's universal law of gravitation. The application of the gravity model in international trade was initially done by the Dutch economist Timbergen in 1962. According to this model, the trade flow between two countries can be determined by their gross domestic product along with the geographical distance between them. The larger the distance between the two countries the smaller the trade flow while the larger the gross domestic product the greater the trade flow (Binh, Duong, & Cuong, 2011).

The gravity model is usually written as follows:

$$T_{ij} = A \frac{Y_i Y_j}{D_{ij}^2}$$

Where: T_{ij} represents the trade flow from country i to country j

Y_i and Y_j represent the gross domestic product of country i and country j

D_{ij} represents the distance between country i and country j

A represents a constant term

The gravity model has been used to estimate flow after trade agreements. Other important variables have been added to the standard model like income difference, infrastructure, and exchange rates. These were found to be vital determinants of trade flow between countries (Binh, Duong & Cuong, 2011).

Economic Integration

The removal of discriminator measures at national borders, elimination of trade barriers and the joining of separate economies into one great economic region, is referred to as economic integration. Economic integration can have different forms and stages; Free Trade Area, Custom Union, Common Market, and Economic Union. The implications of economic integrations have been widely discussed. One of the prominent theories regarding the advantages and disadvantages of economic integration is Viner's Customs Unions Theory. Viner has divided the possible impacts of economic integration into two effects; trade creation and trade diversion. If two nations or more form a trade agreement and trade moves from a member country producing at high cost to a member country producing at low cost, this case is referred to as trade creation. On the other hand, if imports move from a non-member country producing at a lower cost to a member country producing at a higher cost, it is referred to as trade diversion.

This can occur as a result of common tariff in the union which protects the high cost producers inside the union. Viner stressed that gain from trade will be high only if trade creation was greater than trade diversion (Hosny, 2013).

RESEARCH METHODOLOGY AND DATA DESCRIPTION:

This research paper would mainly use secondary data. Both qualitative and quantitative secondary data would be used. In order to evaluate the impact of the QIZ agreement, data will include numbers of QIZ companies along with their distribution by locations, and the values of QIZ exports of textile and apparel to the US market. Data will be compiled from several resources including; QIZ Egypt official website, and World Integrated Trade Solution mainly from 2005 till 2019.

STATISTICAL DESCRIPTION

Number of QIZ companies

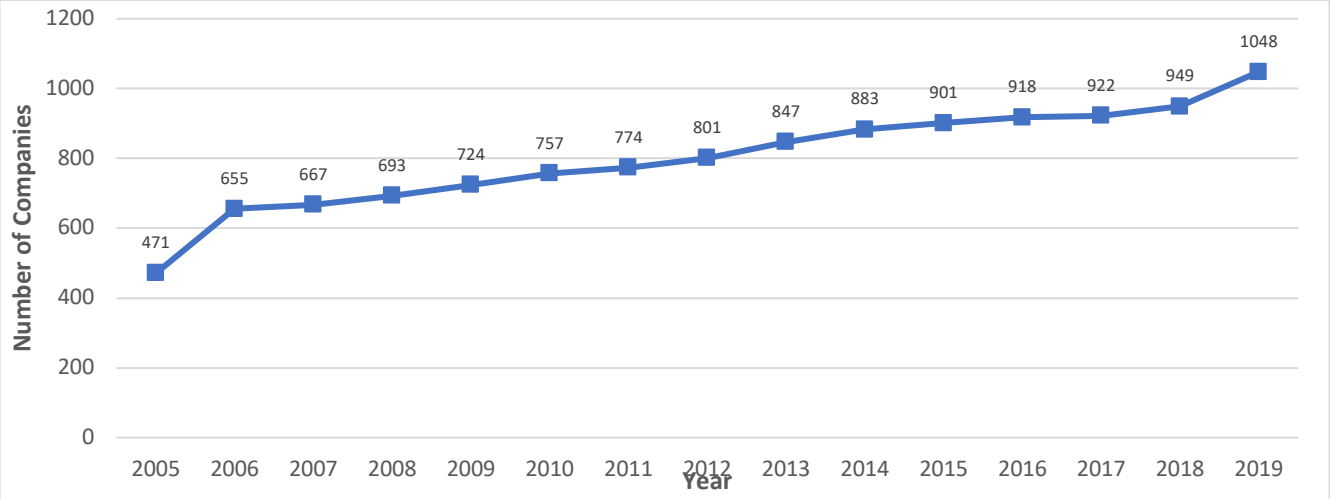


Figure 1: Number of QIZ Companies

Source: QIZ (2019).

Figure 1 shows the number of QIZ companies from 2005 to 2019. The graph shows that there is an upward trend and the number of companies is constantly increasing, which can indicate that the textile sector is highly profitable. In addition, this increase coincides with Nugent & Abdel-Latif (2010) suggestion that investors have greater trade creation benefits compared to trade diversion costs, thus they continue to engage in QIZ activities.

Table (1): QIZ Companies Distribution by Location (2019)

Location	Number of Companies
Alexandria	263
10th of Ramadan	177
Shoubra El Kheima	96
Port Said	66
Nasr City	51
Other Cairo Area	52
Gharbeyya Govr.	42
Ismailia	35
South Giza	21
15th May	13
Kalioub	20
Gesr Suez	12
Giza	23
Badr City	7
Damietta Govr.	3
Beni Suef Govr.	18
Minya Govr.	17
Qualifying Factory	3
El Obour	32

6th of October	46
Suez	9
Monofeya Govr.	31
Dakahleyya Govr.	9
EL Sharkia Govr	2
Total	1048

Source: QIZ (2019).

These specific areas are the locations of QIZ companies. The geographical industrial places in Egypt were determined by the Egyptian government, with the approval of the American government (Ministry of Foreign Trade & Industry, 2005).

Table (2): QIZ Companies by Sector (2019)

Sector	Number of Companies
Textile & textile articles	843
Processed Agricultural Products	78
Chemical products	29
Base metals	16
Leather products	15
Plastic products	11
Articles of stone	10
Furniture	9
Footware & headgear	8
Machinery Equipment	6
Electrical Equipment	6
Engineering Industries	4
Printing Industries	3
Marble & Granite	3
Glass Manufacturing	2
Animal products	2
Drying, and packing of medicinal plants	1
Medical Equipment	1
Stationery	1
Total	1048

Source: QIZ (2019).

In addition to the textile and clothing sectors the QIZ Protocol benefits several Egyptian industries. Because of its relatively high tariffs, the food industry represents a significant opportunity for Egyptian QIZ exports. For example, the US custom rate is 10-30 percent of prepared vegetables as well as of dried onions and garlic, which are eliminated under QIZ. Leather products, athletic footwear and glassware also have similar opportunities (QIZ, 2019).

Egypt's Textile and Apparel Exports to the US

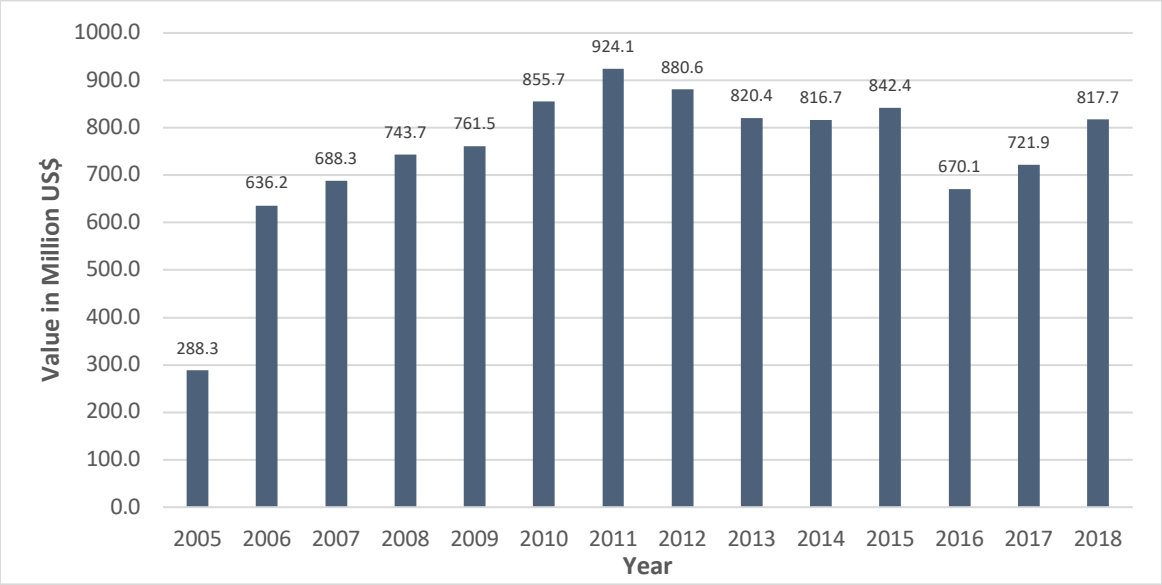


Figure 2: QIZ Textile and Ready-Made Garment Exports (2005-2018)

Source: QIZ (2019).

Figure 2 shows the total textile and ready-made garment exports under the QIZ protocol from 2005 till 2018. A sharp increase can be witnessed from 2005 and 2006 after the agreement. The exports increased from US$ 288.3 million to US$ 636.2 million. The average textile and RMG exports between 2005 and 2018 are US$ 747.7 million. The QIZ textile exports increase steadily from 2006 till 2011. Generally, the QIZ exports show little fluctuations; however, in 2016, the exports dropped to US$ 670.1 million because of the decline in Egypt's cotton production and increase of imports of Asian cottons (Mada Masr, 2016).

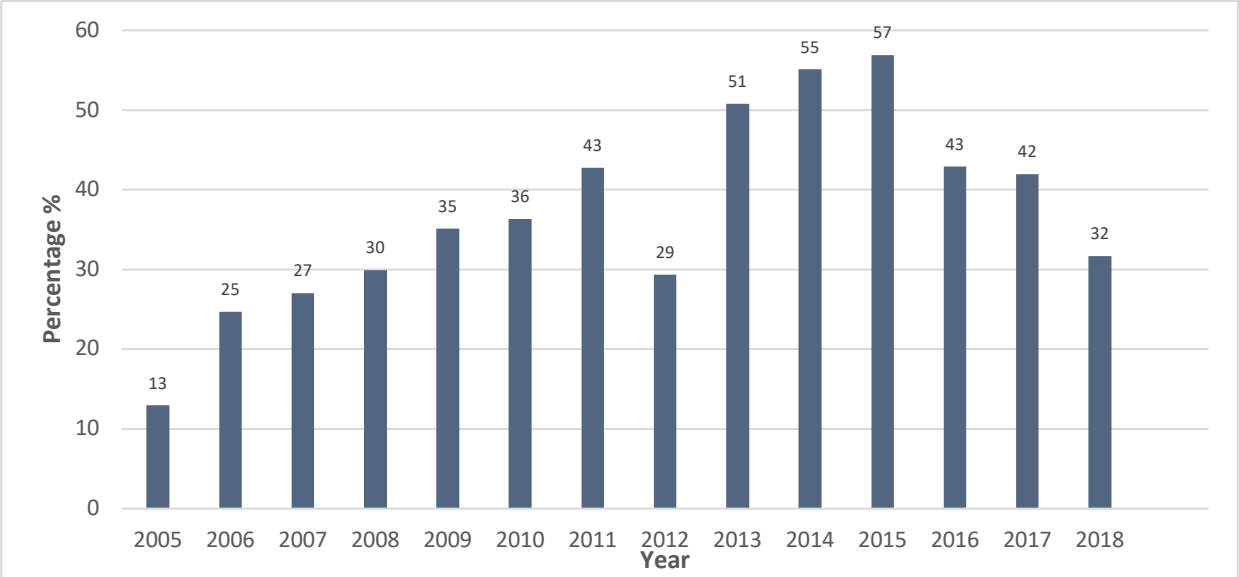


Figure 3: QIZ Textile and Ready-Made Garment Exports as a Percentage of Egypt's Total Exports to the US (2005-2018)

Source: QIZ (2019) and World Integrated Trade Solution (2019).

Figure 3 shows QIZ textile and ready-made garment exports as a percentage of Egypt's total exports to the US from 2005 and 2018. The average percentage between 2005 and 2018 is 37%. The percentage showed a steady increase from 2005 till 2011. However, the percentage dropped to 29% in 2012 because Egypt's oil exports reached almost 50% of the total exports which is the highest record (American Chamber of Commerce in Egypt, n.d.). Nonetheless, the percentage started to increase again between 2013 and 2015. The percentage was 57% in 2015 which is the maximum value throughout this period. In 2016, the QIZ textile exports as a percentage of total exports started to decline, due to the decline in Egypt's long and extra-long staple cotton production (Mada Masr, 2016).

ANALYSIS

We can see that after the QIZ protocol the number of QIZ companies has increased as well as the QIZ textile and RMG exports. This indicates that investors find the QIZ activities quite profitable and the agreement have indeed increased Egypt's trade flow with the USA. Not only that, when we examined QIZ textiles and RMG exports as a percentage of Egypt's total exports we found out that it constitutes a large percentage. This further proves the importance of the Egyptian textile and clothing sector. In fact, in 2018 it was announced that the greatest textile and clothing city will be established in Sadat City. The city will be comprised of almost 568 factories which will be financed by 87% foreign investment and 13% local investment, over a seven years period. It is estimated that the city will provide 160,000 employment opportunities and total production of almost US$ 9 billion yearly. This project is crucial since the textile industry has a key role in the Egyptian economy (Samir, 2018). Thus, the country plans on further development of the textile sector so the impact of the QIZ agreement can expand as well.

CONCLUSION AND RECOMMENDATION

To conclude this paper sought to examine the impact of the QIZ protocol on the Egyptian textile industry. The QIZ Protocol was established by U.S Congress in 1996 to establish economic relations between Israel and its neighbors. Since the Treaty entered into force in February 2005, goods produced jointly by Egypt and Israel have been permitted to enter the USA duty-free. Registered goods must have a minimum value added by QIZ factories of 35%. At least one third (11.7 %) of that added value must be contributed by Egypt, while Israel must make up 10.5%.

The 17 QIZ in Egypt include Cairo, Suez Canal Zone, Beni Suef and Minya. In 2019, the total of QIZ companies was 1048 companies, most of which produce textiles and clothing. Additionally, the average QIZ textile and RMG exports as percentage of Egypt's total exports between 2005 and 2018 was found to be 37%. In 2019, the goal of Egypt was to increase exports of QIZ by almost 15% to USD 1 billion (American Chamber of Commerce in Egypt, n.d.). In addition, in 2018, Egypt's textile sector represented 96% of QIZ's total exports (American Chamber of Commerce in Egypt, n.d.). This shows the importance of the textile industry to the Egyptian economy. Not only is Egypt among the largest trading partner of the United States of America, but it also shows diversification in its export basket (American Chamber of Commerce in Egypt, n.d.).

However, Egypt's exports remain dominated by textiles and clothing products. Thus, the government in Egypt held talks all year round to expand the scope of the program to include tech firms, the protocol has remained unchanged since it was introduced (American Chamber of Commerce in Egypt, n.d.). Therefore, Egypt should try to renegotiate the QIZ agreement to include

technological products, since this would further diversify its exports so as not to depend on only one major sector.

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